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STAFF PAPER

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Project	IBOR Reform and its Effects on Financial Reporting—Phase 2
Paper topic	Effective date and transition requirements

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1. Purpose of this paper

1. The purpose of this paper is to discuss the effective date and transition requirements for the Board's tentative decisions in Phase 2 of the project.

2. At this meeting, the staff will ask the Board to decide on the proposed effective date and transition requirements as set out in this paper.

2. Structure of this paper

3. This paper is structured as follows:

   (a) Background (paragraphs 4-6);

   (b) Summary of staff recommendations (paragraph 7);

   (c) Effective date (paragraphs 8-14);

   (d) Question 1 for the Board (page 4);

   (e) Transition requirements (paragraphs 15-36); and

   (f) Questions 2-3 for the Board (page 10).

3. Background

4. In September 2019, the Board discussed the scope of the issues to be considered in Phase 2 of the project and the proposed order in which these issues should be discussed (project plan).

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5. At its subsequent meetings, the Board tentatively decided to make specific amendments to IFRS Standards with respect to financial reporting issues that arise after the reform of an existing interest rate benchmark including its replacement with an alternative benchmark rate (replacement issues). These tentative decisions are described in AP14 for this meeting. In addition, agenda papers 14A-14C for this meeting set out additional staff recommendations for Phase 2. In this paper we collectively refer to those tentative decisions made by the Board and staff recommendations as ‘proposed amendments’.

6. According to the project plan, the next topic for discussion is the effective date and transition requirements for the proposed amendments.

4. Summary of staff recommendations

7. In this paper, the staff recommend:

   (a) an effective date of annual periods beginning on or after 1 January 2021 with earlier application permitted. If an entity applies these amendments earlier, it must disclose that fact.

   (b) that the proposed amendments should apply retrospectively. This retrospective application:

      (i) applies to those items that existed at the beginning of the reporting period in which an entity first applies the proposed amendments, including amounts accumulated in the cash flows hedge reserve related to hedging relationships that have already been discontinued; and

      (ii) includes reinstating hedging relationships that have been discontinued before the entity first applies the proposed amendments, solely due to changes directly required by the reform , if and only if, the entity can demonstrate that the hedging relationship would not have been discontinued if the proposed amendments were available at that time and that it can be done without the use of hindsight.

   (c) that in the reporting period in which an entity first applies the proposed amendments an entity is not required to present the disclosures required by

paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

5. Effective date

8. In some jurisdictions, there is already clear progress towards the reform of interest rate benchmarks. Public authorities in several jurisdictions are encouraging market participants to accelerate the transition to alternative benchmark rates. This follows the expectation that some major interest rate benchmarks will cease to be published by the end of 2021.

9. In our engagements with stakeholders, including Accounting Standards Advisory Forum (ASAF) and industry forums, they emphasised the importance of the Phase 2 amendments to be available as soon as possible in order to support preparers in applying IFRS Standards during interest rate benchmark reform (IBOR reform) and provide useful information to users of financial statements about the effects of the transition to alternative benchmark rates.

10. The staff think that the urgency around the proposed amendments in Phase 2 is similar to that of the Phase 1 amendments to IFRS 9 *Financial Instruments*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures*, which provided relief from the effects of uncertainties arising from IBOR reform on particular hedge accounting requirements. In that case, the Board issued these amendments in September 2019 with effective date of annual periods beginning on or after 1 January 2020.

11. For these reasons, the staff are of the view that the Board should make the proposed amendments available as soon as possible to allow entities to apply such amendments to financial reporting issues that arise when an entity transitions to alternative benchmark rates. For this purpose, we think that the effective date should be annual periods beginning on or after 1 January 2021 and that earlier application should be permitted.

12. The staff acknowledge that this approach would not allow for a long implementation period—entities are usually allowed at least eighteen months to apply amendments to IFRS Standards.

13. However, the proposed amendments are intended to ease the operational burden on preparers and other affected parties, while continuing to provide useful information to users of financial statements through additional disclosure requirements. Therefore, implementing the proposed amendments should not be burdensome for preparers and would not result in information loss for the users of financial statements. Accordingly, the staff think that a shorter implementation period is justified.

Staff recommendation

14. The staff recommend an effective date of annual periods beginning on or after 1 January 2021 with earlier application permitted. If an entity applies these amendments earlier, it must disclose that fact.

Question for the Board

Question 1 for the Board
1. Does the Board agree with the staff recommendation in paragraph 14 that entities should apply the proposed amendments for annual periods beginning on or after 1 January 2021, with earlier application permitted?

6. Transition requirements

15. The staff note that the areas addressed in the Board's tentative decisions in Phase 2 are linked to one another because, to a large extent, they stem from the modifications directly required by the reform[1] including changes to the hedging relationships and related documentation necessary to reflect those modifications directly required by the reform to the financial instruments that are designated as the hedged item and hedging instrument. Therefore, the potential transition requirements need to apply consistently throughout these areas.

[1] Consistent with the agenda papers for the previous Board meetings on Phase 2, the modifications to contractual cash flows that are required as a direct consequence of IBOR reform and done on an economically equivalent basis are collectively referred to as 'modifications directly required by IBOR reform'.

16. Accordingly, in the following paragraphs, the staff analyse the potential transition requirements on the basis that the same transition approach would apply to all proposed amendments.

6.1 Transition approach

17. IAS 8 describes two transition/application approaches that are typically used throughout IFRS Standards. These are:

    (a) retrospective application—when applying a new accounting policy (amendment to a Standard or new IFRS Standard) to transactions, other events and conditions as if it had always been applied. Such an approach usually includes restatement of comparative information in the financial statements; and

    (b) prospective application—when a change in accounting policy, amendment to a Standard or a new IFRS Standard is applied to transactions, other events and conditions occurring after the effective date.

18. On initial application of IFRS 9, a retrospective transition approach was applied, subject to specific exceptions including not requiring restatement of comparative information.

19. Similarly, the Phase 1 amendments were applied retrospectively to those hedging relationships that existed at the beginning of the reporting period in which an entity first applied those amendments or were designated thereafter, and to the amount accumulated in the cash flow hedge reserve that existed at the beginning of the reporting period in which an entity first applied those requirements. However, the Board noted in paragraph BC6.601 of IFRS 9 and BC287 of IAS 39 that retrospective application would not allow reinstating hedging relationships that have already been discontinued at the date the amendments are applied. Nor would it allow designation of hedging relationships in hindsight. This is because, doing otherwise would be inconsistent with the requirement that hedge accounting applies prospectively.

20. The staff did not consider prospective application for the proposed amendments. This is because applying the proposed amendments prospectively only to replacement issues occurring after the effective date would:

    (a) distort usefulness of information to users of financial statements;

(b) create burden for preparers by requiring them to account differently transactions of the same nature only because they occurred in different reporting periods; and

(c) significantly reduce comparability of financial statements (eg modifications directly required by the reform occurring before the effective date would not be comparable to those occurring after that date).

21. Against this background, the staff considered whether the Phase 2 amendments should be applied retrospectively in a way that is consistent with transition requirements in IFRS 9 including those for Phase 1 amendments, ie the amendments are not applied to financial instruments that have been derecognised at the date of initial application. The staff is of the view that applying the proposed Phase 2 amendments retrospectively is the most appropriate transition approach for the same reasons that are already stated in the Basis of Conclusions to IFRS 9.

22. However, the staff separately considered the application of such an approach to hedging relationships that might have been discontinued solely due to the changes in hedging relationships and related documentation necessary to reflect the modifications directly required by the reform (changes directly required by the reform) before an entity initially applies the Phase 2 amendments.

23. In contemplating about this issue, the staff considered the example of an entity which might have been instructed by its regulator to modify its financial instruments to replace the interest rate benchmark in the period before Phase 2 amendments are available for application. In the absence of the Phase 2 amendments, the entity would account for these modifications by applying paragraph 5.4.3 of IFRS 9. Upon retrospective application of the Phase 2 amendments, the entity would retrospectively apply paragraph B5.4.5 by way of the practical expedient as if that paragraph has always been applied. In context of hedge accounting, if those modifications to the financial instruments resulted in changes to the entity's hedging relationships, those relationships would have been discontinued when applying the current hedge accounting requirements in IFRS 9 and IAS 39 (even if in the relationship continues as before for risk management purposes). However, upon retrospective application of the Phase 2 amendments those hedging relationships could not be reinstated (as they

would have been discontinued) even if the hedging relationships would not have been discontinued if the Phase 2 relief was available at that time.

24. Such an accounting outcome may not provide useful information to users of financial statements as it would not be a faithful representation of the economic effects of those hedging relationships and could be regarded as somewhat punitive to preparers that were complying with the spirit of IBOR reform early by making the changes directly required by the reform before the initial application date of the Phase 2 amendments. This could also result in other entities decelerating their transition processes until after the effective date of the Phase 2 amendments. The staff considered that such an outcome might be going against the objective of a timely transition by market participants to alternative benchmark rates (see paragraph 8) and would not be consistent with the Board's objective for Phase 2.[2]

25. For these reasons, the staff considered whether the retrospective application of the Phase 2 amendments should permit hedging relationships that have been discontinued before the effective date solely due to changes directly required by the reform, to be reinstated. Such an approach would enable an entity to economically maintain the hedging relationships that had been discontinued for hedge accounting purposes and that, other than due to changes directly required by the reform, would have continue to qualify for hedge accounting applying IFRS 9 or IAS 39, until it can be reinstated in the financial statements.

26. More specifically, this approach would assist entities in avoiding situations whereby hedging relationships are required to be 'permanently discontinued' due to changes directly required by the reform, resulting in the recognition of gains or losses in the financial statements that are not reflective of the economic effects of those relationships. In the staff's view, discontinuation solely because changes directly required by the reform occurred in a period before the proposed amendments were available for use would not provide useful information to users of financial statements. This approach could result in situations whereby entities account for

[2] As discussed at the September 2019 Board meeting, the objective of Phase 2 is to provide useful information to users of financial statements about the effects of the transition to alternative benchmark rates on an entity's financial statements and support preparers in applying the requirements of IFRS Standards during IBOR reform.

similar changes to hedging relationships in an inconsistent manner, simply because those changes were made at different times.

27. However, for the avoidance of doubt, the staff highlight that the reinstatement of discontinued hedging relationships should be limited to those hedging relationships where an entity is able to demonstrate that, if the proposed Phase 2 amendments were available at that time, the hedging relationship would not have been discontinued. Although this could be regarded as adding operational burden and effort on prepares, the staff is of the view that the benefits would outweigh the costs of having to maintain such documentation.

28. The staff also acknowledge that the reinstatement of discontinued hedging relationships is inconsistent with the Board's previous decisions in respect to hedge accounting in IFRS 9 as well as transition requirements for Phase 1 amendments (as described in paragraph 19). However, in our view, such an approach would not require the use of hindsight and is consistent with the Board's previous observations that discontinuation of hedge accounting solely due to the effects of the reform without reflecting the underlying economic effects would not provide useful information to users of financial statements.

29. One could also argue that this approach provides less discipline compared to an approach that would not allow reinstatement of any discontinued hedging relationships. However, the staff consider that the requirement for the entity to maintain sufficient documentation that would demonstrate that the reinstated hedging relationships were discontinued solely due to changes directly required by the reform and that the entity has not made use of hindsight, may address this concern.

Staff recommendation on transition approach

30. As a result of the analysis described in paragraphs 17-29, the staff recommend that the proposed amendments should apply retrospectively. This retrospective approach would:

    (a) apply to those items that existed at the beginning of the reporting period in which an entity first applies the proposed amendments, including amounts accumulated in the cash flows hedge reserve related to hedging relationships that have already been discontinued; and

(b) include reinstating hedging relationships that have been discontinued before the entity first applies the proposed amendments, solely due to changes directly required by the reform if and only if, the entity can demonstrate that the hedging relationship would not have been discontinued if the proposed amendments were available at that time and that it can be done without the use of hindsight.

31. For the avoidance of doubt, this approach will not permit the designation of hedging relationships in hindsight. If an entity had not designated a hedging relationship, the proposed amendments, even though applied retrospectively, would not allow the entity to apply hedge accounting in prior periods to items that were not designated for hedge accounting. Doing so would be inconsistent with the general requirements that hedge accounting is applied prospectively.

6.2 Transition disclosures

32. Consistent with the Board's decision for Phase 1, the staff is of the view that on transition to the proposed amendments, an entity need not provide the transition disclosures required in paragraph 28(f) of IAS 8. These requirements are as follows:

> 28 When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:
>
> (f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
>
> (i) for each financial statement line item affected; and
>
> (ii) if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share.

33. Requiring such disclosure for the proposed amendments would not provide useful information to users of financial statements and would be onerous for preparers. This is because, it would require an entity to maintain parallel systems in order to determine the amount of the adjustment for each financial statement line item affected. As such, it may negate the benefit of the relief provided by the Board.

34. The staff think that, generally, the most relevant information for users on transition to new or amended IFRS requirements would be that which would enable them to

properly assess the effect on reported figures of applying those requirements. As discussed at the January 2020 Board meeting, the accounting outcome of the proposed amendments for Phase 2 is such that there will be limited direct effect on the reported figures (eg no resulting gain or loss from modifications directly required by the reform) and hence we do not consider that useful information would be lost in absence of these disclosures.

35. We consider that the disclosures for which the Board tentatively decided in its January 2020 meeting (see agenda paper 14 for this meeting or January 2020 IASB Update) would provide useful information to users of financial statements.

Staff recommendation on transition disclosure

36. The staff recommend that in the reporting period in which an entity first applies the proposed amendments, an entity is not required to present the disclosures required by paragraph 28(f) of IAS 8.

Questions for the Board

Questions 2-3 for the Board
2. Does the Board agree with the staff recommendation in paragraphs 30-31 with respect to transition requirements for the proposed amendments? and 3. Does the Board agree with the staff recommendation in paragraph 36 that in the reporting period in which an entity first applies the proposed amendments an entity is not required to present the disclosures required by paragraph 28(f) of IAS 8?